For-profit education is the leading cause of America's student debt crisis

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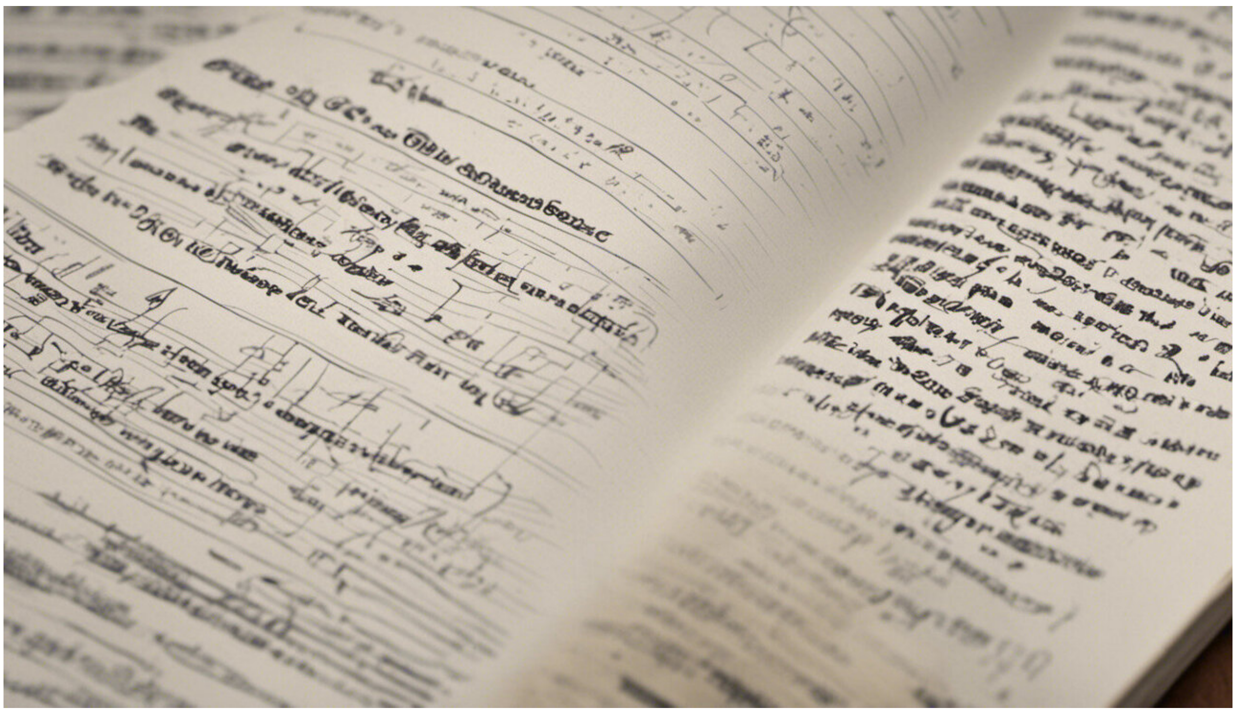

Credit: AI-generated image (disclaimer)

As of February 2019, student debt in the United States was more than $1.5 trillion. The rapid growth of America's student debt is a cause for concern for numerous observers, who fear the outbreak of a financial crisis.

The ever-increasing cost of higher education, combined with a reduction in public subsidies, has meant that students have resorted to loans en masse. This type of debt is very different than other loans contracted by US households, however. Unlike consumer loans or mortgages, higher-education loans in theory enable the accumulation of human capital and can enable graduates to earn higher incomes in the future.

OECD studies clearly show that individual investment in higher education can be strongly rewarded. In the United States, Georgetown University has demonstrated that over their lifetimes, graduates with a bachelor's degree can expect to earn around $1,300,000 more than those without one, and even at the beginning of their careers, they can earn more than $50,000 annually. With this additional income, the average student loan—around $30,000 – can easily be paid back.

Surprisingly, Judith Scott-Clayton of Columbia University has observed that the larger the loan, the fewer problems the student is likely to have with repayments. This can be explained by the fact that while top US universities are expensive—more often than nonprofit, private institutions (corporations or trusts) – they offer good career prospects. Human capital investment in high-quality advanced education is therefore a good thing for the future of both young people and society (public and private gains are high), even if this means significant debt.

Default rates remain high

Given that 81% of American student debt is financed by the federal government, it doesn't have the same capacity to provoke a systemic crisis, as did the subprime disaster.

While this means that the amount of student debt is not a problem in and of itself, defaults on repayments have sharply increased. The Federal Reserve Bank of New York indicated that the rate of serious delinquencies had risen from 6.03% in the first quarter of 2006 to 11.38% in the third quarter of 2013. The 2007-2009 economic crisis had a significant impact on employment in the United States, including for those with a graduate degree. What is surprising is that the rate of delinquency remained high, at 11.42% in December 2018, although employment rates improved considerably.

Using detailed data provided by the Department of Education, Scott-Clayton showed that repayment defaults are particularly frequent when it comes to for-profit institutions. Her predictions are pessimistic: the default rate for borrowers who attended a for-profit college could reach 70% by 2023, she estimated, far higher than the default rate following graduation from a bachelor's degree from a public institution or private nonprofit institution.

$400,000 in advertising per day

In his book, *Diploma Mills: How For-Profit Colleges Stiffed Students, Taxpayers and the American Dream*, Alexander Angulo details these institutions' often-unscrupulous practices, dating back to the 18th century. He notes that their drive for profit is difficult to reconcile with professional and academic standards: "If you're dependent on quarterly profits, tuition revenue, if your main goal is to [impress] investors, this distorts the fundamental purpose of higher education."

In a 2018 study carried out for the US Treasury, Nicolas Turner and Stephanie Riegg observed that on average, the revenue gap between those who attended a for-profit college and those with no higher education is statistically insignificant. This means that a large number of the courses provided by these institutions do not meet the needs of the economy. Based the definition of the OCDE, their investment in human capital is essentially non-existent.

It is thus important to ask why these institutions have had such significant success, quadrupling enrollment between 2002 and 2010 (from 382,600 to 1,590,000 students for bachelor's degrees or equivalent, and higher). Here are a few possible explanations:

They mainly target relatively vulnerable and poorly informed populations—African-Americans, low-income people, first-generation students (whose parents never went to university) – and bought their perceived legitimacy through advertising. For example, in 2012, Phoenix University was Google's number-one advertiser, spending nearly $400,000 per day.

They have benefited from the unwitting support of the US government, which grants federal loans almost systematically, without checking the level of human capital acquired by students. Banks would likely have been more cautious.

The Great Recession (2007-2009) created a counter-cyclical increase in the demand for education (job seekers needed to be better trained, given the drop in demand for workers and the drop in opportunity cost for undertaking studies), which gave these institutions a significant boost.

Predatory behavior

Over the last few years, numerous for-profit colleges have been taken to court for duplicitous and misleading practices. 98.6% of complaints received by the Department of Education concern for-profit institutions. Before it disappeared, the private group Corinthian Colleges was forced to pay a fine of $30 million for false advertising, in particular with regards to its claims about graduate jobs. The crisis in reputation and the counter-cyclical effect of the economic upturn led to a drop of 679,000 students enrolled in for-profit colleges, down 43% between 2010 and 2017. Over the same period, enrollments in public universities rose

11.7%, with a 6.2% increase for nonprofit private universities. The for-profit college bubble is illustrated by the changes in enrollment since 2002.

Lastly, market logic indicates that there could well be a coming implosion for the for-profit sector in US higher education, similar to the subprime crisis. In both cases, loans were granted to vulnerable populations for untenable projects (either in education or real estate). The collapse of the for-profit sector should naturally resolve graduates' loan repayment problems, but this will take several years.

To prevent unscrupulous for-profit institutions from taking advantage of those who are most vulnerable, stricter regulations are required. In particular, the quality of courses and their relevance to market needs must be rigorously checked. Arne Duncan, education secretary under Barack Obama, wanted to curb the excesses of those he called "bad actors" (mainly for-profit institutions). But the system created for this purpose, the "Gainful Employment Rule", did not come into effect prior to Donald Trump's election. The current president has ensured the rule is not enforced.

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